



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
ROBERT W. & MYRTLE DENNIS }

Appearances:

For Appellant: John L. Deahl, Attorney at Law

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; James J. Prditto, Franchise Tax Counsel.

O P I N I O N

This appeal is made pursuant to Section 19 of the Personal Income Tax Act (Chapter 329, Statutes of 1939, as amended) from the action of Franchise Tax Commissioner in overruling the protests of Robert W. and Myrtle Dennis to his proposed assessment of additional tax of \$278.70 for the year 1936.

Appellants filed a joint income tax return for the taxable year 1936, listing under Item 16 "Bad Debts" the amount of \$18,000.00, representing the principal sum of an unsecured promissory note due Appellants from Walter L. Hogan. Commissioner disallowed the deduction.

The sole question presented is whether or not the debt in question was ascertained to be worthless in the year 1936 when it was written off on the books of the Appellants.

The said Walter L. Hogan filed a petition in bankruptcy on November 18, 1935, and was adjudicated a bankrupt on the succeeding day. A trustee in bankruptcy was elected at the first meeting of creditors on December 3, 1935. The bankruptcy schedules, filed in 1935, showed liabilities of \$460,452.36 and assets of \$2,594.65. The bankrupt had himself indicated that approximately \$55,390.00 of the liabilities shown were probably barred by the statute of limitations, and others were of questionable validity. On January 18, 1936, the Trustee in bankruptcy filed an Inventory of property of the bankrupt coming into his possession, consisting solely of three map cases and maps, other scheduled assets being exempt. The bankrupt was discharged February 17, 1936, and the estate was closed October 27, 1937, the Trustee having discovered no assets whatsoever. Only two claims, both unsecured, totaling \$75,813.22 had been filed prior to January 1, 1936. Two other claims, based on recorded judgments, totaling \$29,826.17 were filed in January, 1936.

The Appellants claim that they had no information as to the status of the estate of the bankrupt until January, 1936, other

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than that automatic adjudication has been entered, but that worthlessness was ascertained in 1936 when the secured claims were filed and the Trustee filed his Inventory showing assets of little or no value.

Applicable provisions of the Personal Income Tax Act being identical with corresponding provisions of the Internal Revenue Code, consideration has been given to the ruling of the Treasury Department that worthlessness was ascertained in 1936, yet pertinent federal decisions support, a contrary view.

It is not worthlessness itself which controls in the determination of when a Bad Debt deduction may be taken, but ascertainment of the worthlessness of the debt by the taxpayer.

Higginbotham-Bailey-Logan Co. BTA-566

Such ascertainment of worthlessness must be the exercise of sound business judgment based upon as complete information as is practically obtainable.

H. H. Brown Co., 8 BTA-112

It is the province of Respondent to determine when the Appellants knew or ought to have known, of the worthlessness of the note, and his finding is prima facie correct, casting on Appellants the burden of disproving it.

Avery vs. Commissioner, 22 Fed (2d) 6

We find ample support for sustaining the findings of the Commissioner. The note of the bankrupt was old; no payments of principal or interest were shown to have been received; Appellants knew, or should have known, long prior to bankruptcy, that there was little likelihood of collection as they had been associated with the bankrupt in various realty transactions; no efforts to collect were ever made. Worthlessness was ascertained no later than when the bankruptcy petition was filed, after which the debtor could no longer exercise a freedom of choice as to which creditors he would pay.

The case of Gill & Sons, Forge and Machinery Works, 7 BTA, 1146, does not completely controvert Respondent's argument that worthlessness was ascertained not later than the date of filing the bankruptcy petition, as argued by Appellants for in that case no claim was filed in the bankruptcy proceedings in the year in which worthlessness was claimed, reliance being had on the maritime rights of libel which were not determined until five years later.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protests of Robert W. & Myrtle Dennis, to the proposed additional assessment of \$278.70 for the taxable year 1936 be, and the same is hereby, sustained.

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Done at Sacramento, California, this 15th day of July, 1943,
by the State Board of Equalization.

R. E. Collins, Chairman
J. H. Quinn, Member
Geo. H. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary